

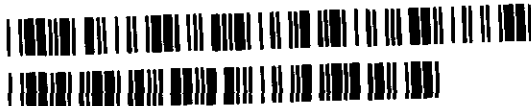
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WESTERN DISTRICT OF WASHINGTON
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CV 00-01806 #00000029

**UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WASHINGTON**

FEDERAL TRADE COMMISSION,

Plaintiff,

v.

CYBERSPACE.COM, LLC, et al.

Defendants.

Case No. C00-1806 L

**OPPOSITION TO PLAINTIFF'S
MOTION TO STRIKE
AFFIRMATIVE DEFENSES OF
DEFENDANTS CHRIS HEBARD
AND COTO SETTLEMENT**

The defendants Chris Hebard and Coto Settlement ("collectively Hebard defendants") oppose the plaintiff's motion to strike all of their affirmative defenses, and in support thereof, state as follows:

I. Background: The FTC's Complaint and the Standard for Deception

The complaint in this case alleges that the defendants engaged in the business practice of selling Internet access or services to consumers by offering them a check for \$3.50 as an inducement to subscribe. In order to cash or deposit the check, the

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1 consumer was required to endorse it. It is noteworthy that nowhere in the complaint is
2 it alleged that defendants failed to disclose to consumers that endorsing the check
3 would obligate them to pay for Internet service. Indeed, such an allegation would be
4 contrary to the facts as alleged generally in Hebard defendants' Fourth Defense.
5 Instead, the complaint carefully limits the alleged failure to disclose by stating at ¶ 15,
6 "Nothing on the face of the check or the invoice-like form alerts" the customer that
7 endorsing the check for cash or deposit obligates them to purchase and pay for Internet
8 service. According to the complaint, it is this failure to have disclosures on the face of
9 the check that underlies the charge in Count Three that defendants "failed to disclose
10 clearly and conspicuously" the consequences of endorsing the check
11

12
13 The Hebard defendants' answer denies all allegations of deception and
14 inadequate disclosure and affirmatively avers in the Fourth Defense that "the nature of
15 the checks was fully disclosed to consumers in clear and conspicuous language, and
16 any consumer who chose not to read the check or disregarded it is not entitled to relief."
17 Answer, p. 4. Moreover, both the complaint and the answer acknowledge that
18 consumers were informed shortly after endorsing the check that they had become
19 subscribers to the Internet service and that they could cancel the subscription at any
20 time including the first thirty days after endorsing the check, i.e., before any payment
21 was due. Complaint, ¶¶ 17, 20, 21; Answer, ¶¶ 17, 20, 21, Third, Fourth, Fifth and Sixth
22 Defense.
23

24
25 In Counts One and Two of the complaint, respectively, the FTC alleges that the
26

1 aforesaid business activity was deceptive in violation of Section 5 because defendants
 2 falsely represented that consumers were legally obligated to pay for the Internet
 3 services and that the solicitation check was a payment based upon a prior or ongoing
 4 business relationship. Count Three also charges deception in the alleged failure to
 5 disclose clearly and conspicuously that endorsing the check obligated the consumer
 6 to pay for the Internet service.
 7

8 Since the FTC's decision *In The Matter of Cliffdale Associates, Inc., et al.*, 103
 9 FTC 110 (1984), the law is beyond dispute that in order for conduct to be deceptive in
 10 violation of Section 5 of the FTC Act, it must satisfy the FTC's definition of deception
 11 articulated in its Policy Statement on Deception issued on October 14, 1983. The
 12 standard was adopted by the Commission in its opinion in the *Cliffdale* case, as follows:
 13

14 In finding the representations in respondents'
 15 advertisements to be deceptive the ALJ accepted complaint
 16 counsel's articulation of the standard for deception. He
 17 concluded that 'any advertising representation that has the
 18 tendency and capacity to mislead or deceive a prospective
 19 purchaser is an unfair and deceptive practice which violates
 20 the Federal Trade Commission Act.' (Citations omitted).
 21 We find this approach to deception and violations of Section
 22 5 to be circular and therefore inadequate to provide
 23 guidance on how a deception claim should be analyzed.
 24 Accordingly, we believe it appropriate for the Commission
 25 to articulate a clear and understandable standard for
 26 deception.

23 Consistent with its Policy Statement on Deception
 24 issued on October 14, 1983 (footnote omitted), the
 25 Commission will find an act or practice deceptive if, first,
 26 there is a representation, omission, or practice that, second,
 27 is likely to mislead consumers acting reasonably under the

1
2 circumstances, and third, the representation, omission, or
3 practice is material....

4 Similarly, the requirement that an act or practice be
5 considered from the perspective of a 'consumer acting
6 reasonably under the circumstances' is not new. Virtually
7 all representations, even those that are true, can be
8 misunderstood by some consumers. The Commission has
9 long recognized that the law should not be applied in such
10 a way as to find that honest representations are deceptive
11 simply because they are misunderstood by a few. Thus, the
12 Commission has noted that an advertisement would not be
13 considered deceptive merely because it could be
14 'unreasonably misunderstood by an insignificant and
15 unrepresentative segment of the class of persons to whom
16 the representation is addressed.' (Footnotes omitted).
17 (Emphasis added).

18 *Id.* at 164-65.

19 Thus, the law is clear that alleged deception does not violate Section 5 of the
20 FTC Act unless the act or practice is considered in the context of a "consumer acting
21 reasonably under the circumstances." *AMREP Corp. v. FTC*, 768 F.2d 1171 (10th Cir.
22 1985). This standard for deception has been uniformly followed by the Commission and
23 the courts. See, e.g., *FTC v. Pantron I Corp.*, 33 F.3d 1088 (9th Cir. 1994); *Southwest*
24 *Sunsites, Inc. v. FTC*, 785 F.2d 1431 (9th Cir. 1986); *Novartis Corp. v. FTC*, 223 F.3d
25 783 (D.C. Cir. 2000); *Kraft, Inc. v. FTC*, 970 F.2d 311 (7th Cir. 1992); *Haskell v. Time,*
26 *Inc.*, 857 F. Supp. 1392 (E.D. Cal. 1994); *In the Matter of Figgie Int'l*, 107 F.T.C. 313
27 (1986); *In the Matter of Thompson Medical Co.*, 104 F.T.C. 648 (1984).

II. Plaintiff's Motion to Strike Hebard Defendants' Affirmative Defenses Should be Denied

A. The Second Defense That Complaint Fails to State a Claim Upon Which Relief Can Be Granted is Sufficient

As shown above, business activity cannot be deceptive under Section 5 of the FTC Act unless a reasonable consumer would be deceived or misled by the conduct in question. Notwithstanding this requirement clearly articulated by the Commission and courts since 1983, nowhere in the FTC's complaint is it alleged that a consumer, acting reasonably, was misled or deceived by the conduct alleged to violate Section 5 of the FTC Act. Indeed, there is not a single allegation that the consumers acted reasonably in not realizing that when they endorsed the check and accepted the \$3.50 payment, they were obligated as subscribers to the Internet service offered and later provided. Thus, this failure to allege a critical element of a prima facie case of deception violative of Section 5 of the FTC Act provides a sufficient basis for defendants' Second Defense that the "complaint fails to state a claim on which relief may be granted." It is well settled that "dismissal [for failure to state a claim for relief] under Rule 12(b)(6) is proper if the complaint lacks an allegation regarding an element necessary to obtain relief." 2 Moore's Federal Practice § 12.34[4][a], p. 12-72.7, (Matthew Bender 3d ed.), citing *Campbell v. City of San Antonio*, 43 F.3d 973, 975 (5th Cir. 1995); *Blackburn v. City of Marshall*, 42 F.3d 925, 931 (5th Cir. 1995); and *Pyles v. United Air Lines, Inc.*, 79 F.3d 1046, 1049 (11th Cir. 1996).

1 The Hebard defendants' identification of the FTC's failure to allege the necessary
2 element of reliance by a reasonable consumer distinguishes this case from those cases
3 cited in its memorandum supporting the request to strike the Second Defense. For
4 example, in *FTC v. Hang-Up Art Enterprises, Inc.*, et al., 1995 U.S. Dist. Lexis 21444
5 (C.D. Cal. 1995), Plaintiff's Memorandum, Attachment C, the motion to strike was
6 granted on the grounds that misrepresentations that deceive any buyers was sufficient
7 to state a claim under Section 5 of the FTC Act. In support of that proposition, the court
8 cited two cases that pre-dated the *Cliffdale* decision. It is apparent from the decision
9 that the distinction between deceiving any buyers as opposed to reasonable buyers was
10 never made in ruling on the motion. The same can be said of the other cases relied
11 upon by the FTC. See, *FTC v. North East Telecommunications, Ltd.*, et al., 1997 U.S.
12 Dist. Lexis 10531 and *FTC v. Image Sales & Consultants, Inc.*, et al., 1997 U.S. Dist.
13 Lexis (N.D. Ind. 1997). In *FTC v. Hayes*, et al., 1997 U.S. Dist. Lexis 7883 (E.D. Mo.
14 1997), the motion to strike was granted because an earlier motion to dismiss for failure
15 to state a claim under Rule 12(b)(6) was denied. Because the court had ruled earlier
16 that the complaint did adequately state a claim for relief, the affirmative defense again
17 raising that issue was stricken.

18
19 The FTC's complaint in this case is silent as to the indispensable element that
20 the allegedly deceptive business practice misled consumers acting reasonable under
21 the circumstances. In the *Cliffdale* decision and its progeny, Section 5's protection
22 against deception does not extend to conduct that has only the tendency or capacity to
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1 deceive, or to conduct that misleads any consumer. It is now necessary to plead and
 2 prove that the alleged deception misled consumers "acting reasonably under the
 3 circumstances." *Id.* The plaintiff's failure to include this element in its complaint renders
 4 the complaint defective and vulnerable to the Second Defense. Accordingly, the motion
 5 to strike the Second Defense should be denied.
 6

7 Support for denying plaintiff's motion to strike is ample. According to 5A Wright
 8 & Miller, Federal Practice & Procedure, Civ.2d at ¶ 1380, Rule 12(f) motions to strike are
 9 generally disfavored and denied:
 10

11 Both because striking a portion of a pleading is a drastic
 12 remedy and because it often is sought by the movant simply
 13 as a dilatory tactic, motions under Rule 12(f) are viewed
 14 with disfavor and are infrequently granted. Thus, in order to
 15 succeed on a motion to strike surplus matter an answer, it
 16 must be shown that the allegations being challenged are so
 unrelated to plaintiff's claims as to be unworthy of any
 consideration as a defense and that their presence in the
 pleading throughout the proceeding will be prejudicial to the
 moving party.

17 *Id.* at 647-50 See also, *Spearman v. Tom Wood Pontiac-GMAC, Inc.*, 2000 WL
 18 33125463 (S.D. Ind. 2000) ("Motions to strike affirmative defenses are disfavored
 19 because they potentially serve only to delay.... A motion to strike affirmative defenses
 20 should be granted only if the affirmative defenses "are insufficient on the face of the
 21 pleadings.".... In other words, affirmative defenses will not be stricken "if they are
 22 sufficient as a matter of law or if they present questions of law or fact." (Citations
 23 omitted).); *Horn v. The Greenwood Rehab. Center, Inc.*, 1984 WL 531 (S.D. N.Y. 1984)
 24 ("Motions to strike defenses are disfavored.... Only those defenses which are clearly
 25
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1 insufficient as a matter of law will be stricken." (Citations omitted)); *Millozni, et al. v.*
2 *Hillside Bank*, 1985 WL 2729 (N.D. IL 1985); 61A Am.Jur.2d, ¶ 503, p. 408-410.

3
4 Plaintiff half-heartedly suggests in a footnote on page 8 of its memorandum that
5 the Hebard defendants' Second Defense does not meet the pleading requirements of
6 Rule 8(a), F.R.Civ.P. in that it does not provide the plaintiff adequate notice of the
7 defense. The suggestion is without merit and incorrectly relies upon Rule 8(a),
8 applicable to the claims for relief by a plaintiff, not a defendant. Rules 8(b) and (c) apply
9 to answers filed by defendants. Rule 8(b) requires that a "party shall state in short and
10 plain terms the party's defenses to each claim asserted " Rule 8(c) requires that "a party
11 shall set forth affirmatively" the specific defenses identified in that subsection, "and any
12 other matter constituting an avoidance or affirmative defense." Further, Rule 8(e)
13 provides that "each averment of a pleading shall be simple, concise and direct." Hebard
14 defendants' Second Defense satisfies the standards in Rule 8(b), (c) and (e). In fact,
15 defendants Second Defense is virtually identical to Form 20 of the appendix of forms
16 attached to the Federal Rules of Civil Procedure. Form 20 suggests the following
17 language in asserting the defense of a failure to state a claim: "First defense — The
18 complaint fails to state a claim against defendant upon which relief can be granted."
19 Hebard defendants' Second Defense is substantively undistinguishable: "The complaint
20 fails to state a claim on which relief may be granted." Accordingly, the plaintiff's attempt
21 to invalidate a form pleading that is appended to the Federal Rules of Civil Procedure
22 for illustrative purposes should be rejected.
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B. Hebard Defendants' Third and Fifth Defenses Are Not Insufficient, Immaterial, or Impertinent to the Relief Requested

Hebard defendants' third defense states as follows: "Defendants have already refunded payments to all consumers entitled to them, and no further relief is warranted." The fifth defense is similar: "Many consumers were offered refunds and rejected them, and such consumers are barred from relief by the doctrine of waiver." These defenses are sufficient, material and pertinent to the plaintiff's claims that the alleged deceptive conduct of the defendants entitles the FTC to consumer redress, refunds of monies paid, and disgorgement of the ill-gotten gains. Complaint, at 7, ¶ 3.

In answer to a complaint, the defendant is required under Rule 8(c) to set forth "affirmatively...any other matter constituting an avoidance or affirmative defense." One such avoidance or affirmative defense to the plaintiff's claim for consumer redress and disgorgement is the fact that the defendants have already refunded or offered to refund payments to all consumers allegedly entitled to a refund.

The plaintiff's reliance on *FTC v. Amy Travel Serv., Inc.*, 875 F.2d 564 (7th Cir. 1989), for its argument that the defendants' Third and Fifth Affirmative Defenses are irrelevant to allegations of deception is misplaced for several reasons. First, the argument fails to distinguish between facts relevant to the issue of deception and facts relevant to the issue of relief requested. Second, *Amy Travel* did not involve a motion to strike affirmative defenses. The holding relied upon by the FTC relates to the exclusion of certain evidence at trial that some customers were satisfied with the

1 defendant's services. The court of appeals upheld the exclusion on the grounds that
 2 the FTC does not have to prove that every customer is injured in order to establish
 3 deception. Thus, Amy has nothing to do with Hebard defendants' affirmative defenses
 4 that consumer redress or disgorgement is not appropriate in this case because
 5 consumers entitled to refunds have either received refunds or refused them when
 6 offered. Clearly, the Hebard defendants should be allowed to plead affirmatively that
 7 the refunds were made or offered and, therefore, may serve as an avoidance of the
 8 relief sought by the plaintiff. As the court held in *FTC v. Hang-Up Art Enterprises, Inc.,*
 9 *et al.*, 1995 U.S. Dist. Lexis 21444 (C.D. Cal. 1995), a motion to strike will not be
 10 granted if the insufficiency of the defense is not clearly apparent, or if it raises factual
 11 issues that should be determined on a hearing on the merits." In that case, the
 12 affirmative defense raised factual issues as to causation of alleged damages and the
 13 motion to strike was denied. In this case, the Third and Fifth Defenses raise factual
 14 issues relating to the FTC's claims for relief consisting of consumer redress, refunds and
 15 disgorgement. For this reason, the motion to strike these defenses should be denied.

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 19 **C. Defendant Hebard's Fourth Defense**
 20 **Is Not Redundant**

21 The plaintiff argues that defendant Hebard's Fourth Affirmative Defense ("The
 22 nature of the checks was fully disclosed to consumers in clear and conspicuous
 23 language, and any consumer who chose not to read the check or disregarded it is not
 24 entitled to relief") should be stricken because it is redundant of their denials of the
 25

1 complaint's allegations that the defendants failed to disclose clearly and conspicuously
2 material conditions relating to the consumers' endorsing defendants' checks.

3 One of the factual issues in this case is whether the consumers acted reasonably
4 when they accepted defendants offer of \$3.50 by endorsing the check despite multiple
5 disclosures that the endorsement would obligate them to pay for an Internet services.
6 In addition to denying the FTC's allegations that the disclosures were inadequate, the
7 defendants have affirmatively pled that they, in fact, did make affirmative disclosures
8 that were clear and conspicuous and that informed the consumers of the consequences
9 of cashing or depositing the \$3.50 check. In other words, denying allegations of a
10 failure to adequately disclose is not the same thing as an affirmative assertion that
11 disclosures were made repeatedly that relate directly to the factual issue of whether the
12 consumers acted reasonably in endorsing the check. Rule 8(b) of the F.R.Civ.P.
13 requires a defendant to "state in short, plain terms the party's defense to each claim
14 asserted." The Hebard defendants did precisely that in their denials to allegations of
15 failure to disclose clearly and conspicuously in paragraph 30 of the complaint. See
16 Answer, ¶ 30. Rule 8(c) also requires that in answering a complaint the defendant
17 "shall set forth affirmatively...any other matter constituting an avoidance or affirmative
18 defense." Hebard defendants have properly set forth, in accordance with Rule 8(c), the
19 additional matter of fully disclosing to consumers the implications of endorsing the
20 check, i.e., agreeing to pay for Internet services. Accordingly, plaintiff's motion to strike
21 the Fifth Defense should be denied.
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D. Hebard Defendants' Sixth Defense Is Not Insufficient, Immaterial, or Impertinent

Rule 8(c) provides that the defendant shall affirmatively plead certain enumerated defenses including "accord and satisfaction," "res judicata," "estoppel" and "release." As the plaintiff aptly states in its memorandum at p. 12, these defenses "may be waived if not pleaded" in defendants' answer. Defendants' answer satisfies the requirements of Rules 8(b) and 8(c), respectively, that the defendant "shall state in short, plain terms the party's defenses," [and], "shall set forth affirmatively" the defenses specifically identified in Rule 8(c). Further, Rule 8(e) provides that "each averment of a pleading shall be simple, concise and direct." Defendant Hebard's Sixth Defense satisfies these requirements in that it provides notice to the plaintiff that its claim for redress or disgorgement could be barred in whole or in part by the acts of consumers in accepting refunds or other payments or credits from the defendants. All of these methods of payments, refunds or credits to consumers fall within the specific affirmative defenses identified in Rule 8(c), including, but not limited to, accord and satisfaction, res judicata, estoppel and release.

Plaintiff's argument that these defenses are insufficient, immaterial or impertinent to its claims that defendants' conduct was deceptive in violation of Section 5 is no more persuasive relating to the Sixth Defense than it was when directed to the Third and Fifth Defenses. As noted above, these defenses are directly relevant to the relief sought and are not related to whether there can be deception when some consumers are either

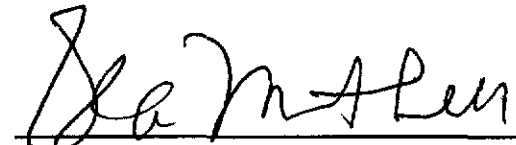
1 satisfied or not shown to have been injured. In sum, these affirmative defenses raise
2 factual issues relating to the relief sought and therefore should not be stricken.

3
4 **CONCLUSION**

5 For the foregoing reasons, the plaintiff's motion to strike the Hebard defendants'
6 Second-Sixth Defenses should be denied.

7 Respectfully submitted,

8
9
10 By:


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CERTIFICATE OF SERVICE

I, hereby, certify that a copy of the foregoing document was mailed, first-class, postage prepaid, this 27 day of April, 2001 to the following:

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